

TEXAS INSURANCE LAW NEWSBRIEF

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FOLLOWING RECENT TEXAS SUPREME COURT PRECEDENT, DALLAS APPEALS COURT RULES TRIAL COURT ABUSED ITS DISCRETION BY DENYING AN INSURER'S MOTION TO SEVER AND ABATE EXTRA-CONTRACTUAL CLAIMS IN UM/UIM ACTION

Recently, the Dallas Court of Appeals concluded a trial court abused its discretion by denying an insurer and its adjuster's motion to sever and abate a claimant's underinsured motorist (UIM) claim in the district court action. The ruling comes on the heels of the Texas Supreme Court's ruling in *In re State Farm Mut. Auto. Ins. Co.*, No. 19-0791, 2021 WL 1045651 (Tex. Mar. 19, 2021) (orig. proceeding) (the "Pending Action")

In re State Farm Mut. Auto. Ins. Co. and *Giap Dang*, No. 05-20-00815, 2021 WL 1422656 (Tex. App.—Dallas Apr. 15, 2021) involved a claim for UIM benefits by an insured from his insurer, State Farm. The insured was involved in a motor vehicle accident and sued the alleged underlying tortfeasor for damages, claiming over \$80,000 in damages. After the insured settled the personal injury claim, he sought UIM benefits from State Farm, whose adjuster, responded by sending an offer of \$3,650 to settle the claim.

According to the insured, his insurer did not provide an explanation as to the basis for its decision on his UIM claim, so he sued State Farm alleging various violations of the Insurance Code but not alleging a breach of the insurance policy. Curiously, the insured demanded the UIM policy limits, treble damages under the Insurance Code, and attorney's fees.

State Farm responded by filing a motion for separate trials and abatement, arguing the trial court should sever the car accident portion of the case from the "premature" extra-contractual claims and abate them until the trial court ruled that the insured was "legally entitled to recover" from the alleged underinsured motorist. The insured argued that there was no breach-of-contract claims to sever because he had only brought statutory claims. The trial court agreed and denied State Farm's motion.

After State Farm filed a petition for writ of mandamus with the Dallas Court of Appeals arguing the trial court abused its discretion by denying the motion and that it had no adequate remedy by appeal, State Farm asked the appeals court to "await guidance from the Texas Supreme Court on the merits" of its petition because the identical issue before the appeals court—whether severance and abatement required when a claimant only brings extra-contractual claims in a UIM action—was about to be decided by the Texas Supreme Court.

The Texas Supreme Court eventually held that to establish damages from an insurer's violation of the Insurance Code, an insured must establish either (1) a right to receive benefits under the policy, or (2) an injury independent of a right to benefits. The claimants in this case argued State Farm caused them injuries independent of their rights to benefits due to the violations of the Insurance Code. The Texas Supreme Court disagreed holding the only damages claimed were predicated on the insurer's obligation to pay under the UIM policies, which was not "truly independent of the right to receive policy benefits." Consequently, the Texas Supreme Court ruled that insureds cannot recover for alleged Insurance Code violations under an "independent-injury" theory, and the appropriate procedure is to hold a bifurcated trial that first determines whether the insurer breached the policy and then, if such is established, to determine whether there was a violation of the Insurance Code. Thus, a trial court's denial of a motion seeking to bifurcate a case involving a claim for UIM benefits and alleged violations of the Insurance Code was an abuse of discretion, and the insurer lacked an adequate remedy on appeal for the resources wasted seeing reversal of the improperly conducted proceedings.

Once the Texas Supreme Court issued its ruling, the Dallas Court of Appeals followed the Court's precedent and concluded that the insured in this case had not alleged an injury independent of a right to policy benefits, so the proceedings had to be bifurcated, and the issue of whether the insured was entitled to UIM benefits was required to be adjudicated before adjudicating the issue of whether the insured could recover damages for violations of the Insurance Code.

U.S. MAGISTRATE JUDGE RECOMMENDS FEDERAL COURT DISMISS INSURED'S COVID-19-RELATED BREACH OF CONTRACT AND EXTRA-CONTRACTUAL CLAIMS

U.S. Magistrate Judge Susan Hightower recently issued a report and recommendation to the U.S. District Court for the Western District of Texas recommending dismissal of an insured's breach of contract claim and related extra-contractual claims arising from the insured's claim for business interruption coverage arising from the COVID-19 pandemic.

In Ilios Production Design, LLC v. The Cincinnati Ins. Co., Inc., et al., No. 1:20-CV-857-LY, 2021 WL 1381148 (W.D. Tex. Apr. 12,

2021), the district court, at the request of the insurer, sought a report and recommendation from the Magistrate Judge regarding the insurers' motion to dismiss the insured's claims. The insured, a lighting and production design company, had a policy of insurance that included "business interruption" coverage. When the insured was forced to close due to local and statewide stay-at-home orders issued to help curtail the spread of the virus that causes COVID-19, the insured subsequently made a claim under its policy, asserting that it had suffered "direct physical loss" as a result of the pandemic and the civil authority orders rendering its premises temporarily uninhabitable and unusable for business purposes. The insurer denied the claim, stating that the losses were not covered under the policy because the claim did not involve a "direct, physical loss to property . . . caused by a Covered Cause of Loss."

The insured sued in state court, alleging breach of contract, common law bad faith, and additional extra-contractual claims. After the case was removed to federal court by the insurer, the insurer filed a motion to dismiss based on the insured's failure to state a claim upon which relief could be granted.

In construing the underlying policy, the Magistrate agreed with the insurer that the policy only covered a "direct physical loss to property" or loss of income related to damage to property, but it did not cover economic loss caused by a virus or efforts to protect the public from that virus. That is, a "direct physical loss" required a "distinct, demonstrable, physical alteration of the property," under state law, and the insured was focused on "physical loss" while ignoring the policy's unambiguous requirement that a "direct physical loss" to the insured's property occur to trigger coverage.

The insured had not pleaded that the virus was ever present at its premises, but even if it had, the Magistrate concluded that the presence of the virus at the insured's property would not constitute a direct physical loss because the virus did not threaten the structures and could be eliminated from surfaces with routine cleaning and disinfectant.

As to the civil authority provision, the Magistrate emphasized that such provision also required "direct physical loss" to property and required the physical damage to prompt the act of civil authority, not vice-versa. Additionally, the civil authority orders limited the insured's operations, but the order did not prohibit the insured from accessing its premises.

Finally, the insured argued that the lack of a virus exclusion undercut the insurer's attempt to deny claims involving viruses. In response, the Magistrate pointed out that such an exclusion is only triggered if there were coverage under the policy, and since the Court had determined there was no coverage under the policy, the presence or absence of a virus exclusion was irrelevant.

As a result, the Magistrate found the policy expressly excluded coverage for the insured's insurance claim and recommended dismissal of the insured's claim, as well as the extra-contractual claims, which were premised on the underlying claim.

HOUSTON APPEALS COURT AFFIRMS TRIAL COURT'S ISSUANCE OF SUMMARY JUDGMENT IN FAVOR OF INSURER DISMISSING INSURED'S CLAIMS FOR BREACH OF CONTRACT AND VIOLATIONS OF THE INSURANCE CODE

Last week, an appeals court in Houston affirmed the trial court's decision to dismiss an insured's claims against her insurer for breach of contract and alleged violations of the Insurance Code.

Powell v. USAA Cas. Ins. Co., No. 01-19-00308, 2021 WL 1414217 (Tex. App.—Houston [1st Dist.] Apr. 15, 2021) involved an insured's claim for coverage under a homeowner's policy that was denied by an insurer because the insured presented no evidence that her claimed losses were covered under the policy or occurred during the policy period.

In 2010, the insured purchased a home that was in disrepair and agreed as part of the purchase to make repairs to the home. Indeed, the insured spent at least \$100,00 repairing the pool, fence, air conditioner, plumbing, roof leaks, and broken windows and doors. Between 2014 and 2016, the insured obtained three homeowner's policies from the insurer, but the only one at issue was one issued on April 5, 2016 and was effective for one year. The policy provided coverage against "sudden and accidental," direct, physical loss to tangible property caused by a covered peril that was not subject to an exclusion. Such exclusions included windstorm or hail, wear and tear marring, deterioration, vermin, or damage caused directly or indirectly by water damage arising from any of the aforementioned sources. Additionally, a condition of coverage under the policy was that the loss occurred during the policy period.

On April 17-18, 2016, the Houston-area experienced massive flooding, and the insured made a claim with FEMA for flood damage to her house. The claim was approved by FEMA, and the insured was paid to repair flood damage to several rooms and items of personal property.

On June 14, 2016, the insured filed a claim with the insurer for damage to the interior of her home from an air conditioner leak and an overflowing washing machine. The insurer acknowledged the claim that same day and subsequently sent a plumber to inspect the leaks. The plumber reported the washing machine overflowed due to tree roots in the drain line, and the air conditioning leak was caused by pin-hole leaks in the piping that were not leaking at the time of the inspection and that condensation dripping off of uninsulated pipes may also have contributed to the water damage in the insured's home.

The insured hired a remediation company to address the washing machine overflow. The company found water damage due to a leaking drip pan under the air conditioning unit and additional minor damage from the April floods and stated that the winds blew tree limbs onto the roof, causing water damage to various ceilings in the home.

Upon inspection by the insurer's adjuster and a representative from the remediation company, the insurer determined that the insured had an air conditioning system leak, a roof leak, and a washing machine overflow that damaged the master bedroom. It then hired a

consulting firm to inspect the damage and determine the cause and origin of the damage.

On July 28, 2016, the consultants reported that hail on inch in diameter fell at the insured's home for more than twenty minutes on April 17, 2016. The report also concluded that neither wind nor hail damage caused the roof and attributed various Causes, such as gaps between plumbing vent pipes and flashing, animal damage to vent pipes, and condensation leaks from the air conditioning system, unsealed brick veneer, and fractured roof decking from workers walking on the roof as causes of the water damaged observed in the home.

On August 8, 2016, the insurer inspected the property a second time. During this inspection, the insured made comments that raised concerns with the adjuster that the insured may have misrepresented the condition of her house when applying for the policy and when the damage allegedly occurred. The insurer thus referred the claim to their internal investigation unit, who obtained statement from the insured.

The insured first noticed wet carpet near the washing machine in March 2016 and first noticed damage in the wet bar in April 2016. She also made inconsistent statements as to the damage covered by FEMA. Moreover, in an examination under oath requested by the insurer, the insured's testimony called into question whether the washing machine overflowed after the effective date of the policy and whether the insured accurately described and valued her personal property damage.

In July 2016, the insurer denied the insured's claim, stating that the insured misrepresented and concealed facts in the presentation of the claim, as the insured admitted the washing machine leak occurred prior to the policy period's start date and could not recall when the damage from the air conditioner leak occurred. The insurer further determined the roof damage was caused by wear and tear and maintenance issues.

The insured filed suit, asserting claims for breach of contract and violations of the Insurance Code. The insurer followed by filing a motion for summary judgment, arguing that the insured had no evidence that her claimed losses were covered under the terms of the policy or occurred during the policy period. The insurer also pointed out that the house was in disrepair with then insured purchased it and that it incurred damage prior to the effective date of the policy, and the damage was not covered under the policy.

First, the insured responded by arguing that the insurer could not seek summary judgment on a ground not raised in its rejection letters, which the Court summarily denied, holding that even if such an argument was supported by prior case law, the insurer's reasoning for rejecting her claim was not inconsistent with what was in its rejection letters.

Second, the insured argued a fact issue existed as to whether the roof leaks were caused by wind or hail during the floods rather than gradual, long-term leaks. The Court initially held that, under the terms of the policy at issue, the physical damage to tangible property would be covered only if the damage occurred during the policy period. Because the insured admitted the washing machine leak occurred prior to the start of the policy period, and because the insured did not provide any evidence to show that her air conditioning leak occurred during the policy period, the Court concluded summary judgment was appropriate. As to her claim for the roof damage, the insured argued that disputed facts existed because, although she could not say exactly when the damage occurred, the insured's consultant reported that hail had hit her house on April 17, 2016 for more than twenty minutes. However, the insured also admitted that the damage could have occurred in 2013 or 2015, which the Court held precluded a genuine issue of material fact. Thus, summary judgment was appropriate on the roof issue as well.

The Court affirmed the summary judgment on the issue of whether any delay by the insurer in investigating the claim exacerbated the insured's mold issues because the policy expressly excluded such damage, and the insured failed to provide evidence to create an issue of material fact. The Court also upheld the summary judgment as to whether the policy covered flood damage because the insured conceded that the policy expressly excluded such damage. Finally, the Court pointed out that the insured did not argue or point to any evidence showing the insurer violated the Insurance Code, so the summary judgment as to that claim was affirmed as well.